



The City of Seattle Washington Comprehensive Annual Financial Report

For the Fiscal Year Ended December 31, 2005



The City of Seattle **Washington**

Comprehensive Annual Financial Report

**For the Fiscal Year Ended
December 31, 2005**



Department of Executive Administration

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Comprehensive Annual Financial Report

For Year Ended December 31, 2005

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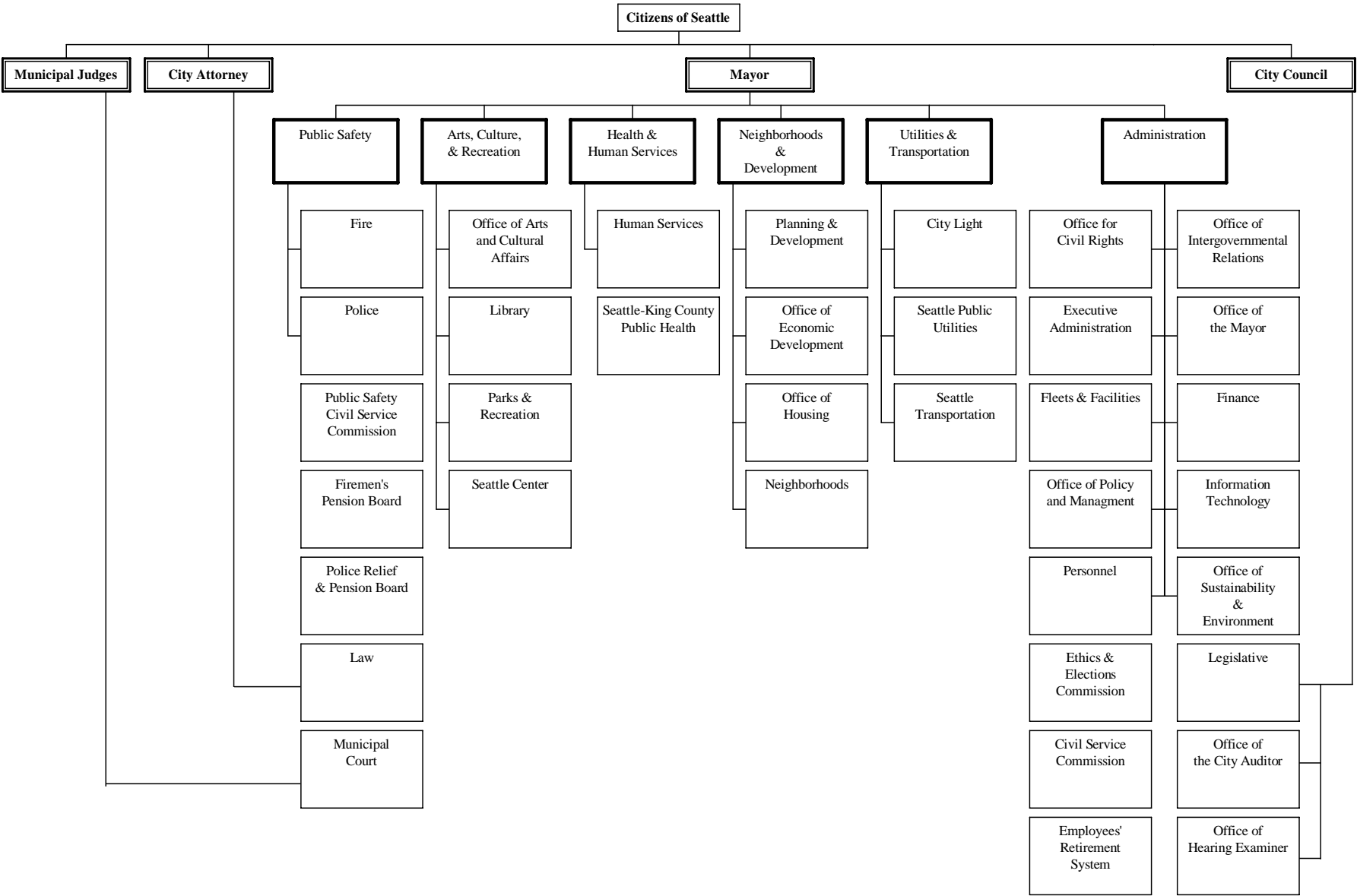
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CITY ORGANIZATION CHART



CITY OF SEATTLE ELECTED OFFICIALS



Gregory J. Nickels
Mayor



Thomas A. Carr
City Attorney

CITY COUNCIL



Sally Clark



Richard Conlin



David Della



Jan Drago



Jean Godden



Nick Licata
Council President



Richard J. McIver



Tom Rasmussen



Peter Steinbrueck

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City of Seattle Department of Finance

Dwight Dively, Director
Gregory J. Nickels, Mayor

July 18, 2006

The Honorable Mayor and
Members of the City Council:

I am pleased to submit to you the 2005 Comprehensive Annual Financial Report (CAFR) of the City of Seattle, Washington. The Department of Executive Administration has prepared this report to present the financial position of the City of Seattle on December 31, 2005, and the results of its operations and the cash flows of its proprietary fund types and changes in plan net assets of its pension and private-purpose trust funds for the year then ended. The financial statements and supporting schedules have been prepared in accordance with generally accepted accounting principles and meet the requirements of the State Auditor and the City Charter.

Washington State law requires an annual audit of the City's financial statements by the independently elected State Auditor. The State Auditor conducts his examination in accordance with generally accepted auditing standards and provides an independent assessment that helps assure fair presentation of the City's financial position and results of operations and the cash flows of its proprietary fund types and changes in plan net assets of its pension and private-purpose trust funds. In addition to the opinion on the City's financial statements included in this report, the State Auditor also issues separate reports on internal control and compliance with laws and regulations that meet the requirements of the Single Audit Act and related OMB Circular A-133. These reports are available in the City's separately issued Single Audit Report.

The accuracy of the City's financial statements and the completeness and fairness of their presentation is the responsibility of City management. The City maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded against loss or unauthorized use and that financial records can be relied upon to produce financial statements in accordance with generally accepted accounting principles. The concept of reasonable assurance recognizes that the cost of maintaining the system of internal accounting controls should not exceed benefits likely to be derived. Comprehensive written policies support the system and the Office of City Auditor reviews internal accounting controls based upon request or observed need.

Management's discussion and analysis (MD&A) immediately follows the State Auditor's report. It provides a narrative introduction, overview, and analysis to accompany the basic financial statements. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it.

Profile of the Government

The City of Seattle was incorporated on December 2, 1869. The City operates under a City Charter adopted on March 12, 1946, providing for a nonpartisan Mayor-Council form of government. The City Council is composed of

nine members elected at large to four-year terms. The City provides the full range of municipal services authorized by its charter and operates four rate-funded utilities.

The City of Seattle is a primary government for financial reporting purposes. Its governing body is elected by the citizens in a general, popular election. This report includes all organizations and activities for which elected City officials exercise financial accountability. Certain organizations created by or related to the City, for which the City is not financially accountable, have been excluded from this report. Joint ventures, component units, and contingent liabilities, which exist from relationships with organizations created by the City, are included in this report. The notes to the financial statements further discuss the City as a financial reporting entity.

The City provides a full range of services, including the City's infrastructure services. The City builds and repairs roads; maintains electric, water, solid waste, sewer and drainage services; provides police and fire protection as well as judicial services; administers land use policy; and takes an active role in commercial and industrial development and environmental protection. The City designs and maintains many parks and golf courses, coordinates recreation activities, maintains libraries, fosters neighborhood livability, and works to preserve a satisfactory living environment for both the community and individuals.

Budgets and Budgetary Accounting

The City Council approves the City's operating budget. In addition, the City Council annually approves two separate but related financial planning documents: the Capital Improvement Program (CIP) plan and the Community Development Block Grant (CDBG) program allocation.

The operating budget is proposed by the Mayor and adopted by the City Council at least 30 days before the beginning of the fiscal year. The budget is designed to allocate available resources on a biennial basis among the City's public services and programs and provides for associated financing decisions. On a biennial basis, the annual budget is adopted and the following year's budget is endorsed. The budget appropriates fiscal year expenditures and establishes employee positions by department and fund except for project-oriented, multi-year appropriations made for capital projects, grants, or endowments.

The CIP plan is also proposed by the Mayor and adopted by the City Council at least 30 days before the beginning of the fiscal year. The CIP is a six-year plan for capital project expenditures and anticipated financing by fund source. It is revised and extended annually. The City Council adopts the CIP as a planning document but does not appropriate the multi-year expenditures identified in the CIP. These expenditures are legally authorized through the annual operating budget or by specific project ordinances during the year.

The CDBG planning process allocates the annual grant awarded by the federal government. Allocations are made to City departments and non-City organizations. Legal authority is established each year by a separate appropriation ordinance for the Housing and Community Development Revenue Sharing Fund.

The control imposed by the City's adopted budget is maintained through the integration of budgetary accounts in fund ledgers for all budgeted funds. An encumbrance system accounts for purchase orders and other contractual commitments.

Factors Affecting Financial Condition

The 2001 recession, which was relatively mild at the national level, hit the Puget Sound region hard. Over a 33-month period that ended in September 2003 the region lost 6.9 percent of its employment, compared to a 2.1 percent drop nationwide. The transition from decline to growth has been gradual, with very modest growth in 2004 followed by an acceleration of growth during 2005. In 2005 the region's employment increased at a healthy 3.1 percent pace, led by strong growth in construction and aerospace. Boeing has added over 10,000 jobs since June 2004 as it has increased production to meet the strong demand for its 777, 787, and 737 models. Boeing booked 1,002 new orders in 2005 making it one of the strongest years ever.

The improving economy has led to significant improvement in the City's revenue picture. General Fund revenue increased by 8.3 percent in 2005, led by an 11.5 percent gain in retail sales tax revenue and 10.4 percent growth in Business and Occupation (B&O) tax receipts. Retail sales and B&O tax revenue growth was led by a strong upturn

in construction activity, as a number of new office, commercial, hotel, and residential projects broke ground and construction of Sound Transit's light rail project ramped up. With the real estate market booming, revenue from the City's real estate excise tax (REET) increased by 31.0 percent in 2005, and has more than doubled since 2002.

Economic outlook

Most national economic forecasts anticipate continued growth through 2008, although the pace of growth is expected to slow from 2004-05 levels. For the Puget Sound region, employment is forecast to grow at an average rate of 2.6 percent per year during the 2006-08 period; the comparable rate for personal income growth is 6.7 percent annually. Aerospace is expected to continue its expansion through 2008 as Boeing increases its production of airliners to meet the recent surge in demand, and Microsoft recently announced plans to spend \$1 billion over the next three years to add 3.1 million square feet to its Redmond campus - enough room for 12,000 employees. In addition, several new office, residential, and biotechnology projects are underway in the South Lake Union neighborhood, and Washington Mutual Bank's new downtown office tower is scheduled to open in 2006.

Given expectations that the regional economy's expansion will continue, most City revenues are forecast to grow at a healthy pace through 2008. Sales tax revenue growth rates are forecast to fall in the 4.4 to 6.0 percent range over the next three years. B&O tax revenue is expected to increase by 6.6 percent in 2006 and 6.2 percent in 2007. However, in 2008 new state-imposed B&O allocation and apportionment rules are scheduled to take effect. The new rules are expected to reduce B&O tax revenue by about \$20 million in 2008. Cities will seek changes in this law over the next two legislative sessions.

While most economists anticipate continued expansion through 2008, there are a variety of risk factors that could lead to a less favorable outcome. Energy prices remain a concern because of their ability to disrupt the economy and boost inflation. The steep run up in housing prices that has occurred in recent years has some economists concerned that much of the nation is experiencing a housing bubble that could cause a major slowdown in the economy or even a recession, if it deflates too rapidly. However, several studies of the Puget Sound real estate market suggest that there is only a minimal risk of significant housing price deflation in this area. Also of concern are the nation's twin deficits, the federal budget and current account deficits, and their potential impacts on interest rates and the financial markets.

MAJOR INITIATIVES

2006 Budget: The improved economy and the strong revenue forecast provided additional funds for 2005 and 2006 beyond what was anticipated when the 2005 Budget was adopted and the 2006 Budget was endorsed in November 2004. Mayor Greg Nickels directed these resources be spent in two ways. First, some targeted one-time investments were identified that will reduce future costs, improve performance, or allow the use of cash rather than anticipated bond issues. Second, high-priority services were added, including several programs that had to be cut in the first part of the decade.

The Mayor and Council used the 2006 Endorsed Budget as the basis for the 2006 Adopted Budget. In the City's biennial budget process, a second-year budget is endorsed by the Mayor and City Council at the time the first-year budget is adopted. This Endorsed Budget is then revised for the second year of the biennium. For many programs, the 2006 Endorsed Budget became the 2006 Adopted Budget with no changes or with the only changes being updates to economic assumptions, such as salary and benefit calculations. The Budget also built on efficiencies that were achieved over the last few years. The City has eliminated low-priority activities and streamlined management of many functions.

Financial Policies: The 2006 Budget continued the City's commitments to strong financial policies. The Emergency Subfund was funded to the maximum amount allowed by state law, approximately \$36 million for 2006. All existing reserve accounts were maintained or increased. New reserves were set up in the Police Department to cover the costs of future equipment replacement, including video cameras in patrol cars. Only a small amount of new General Obligation debt (\$24 million) was included in the 2006 Budget, with the largest amount for potential Airport Way Center (formerly Park 90/5) refinancing that will be reduced if the City succeeds in its suit to recover earthquake damage expenses from the property insurance carrier for this facility.

Transportation: Improving transportation is one of the City government's highest priorities. The 2006 Budget maintained all existing transportation programs and funded significant new capital projects, including \$5.9 million for street resurfacing, which will help pave about 76 lane-miles in 2006, and \$500,000 for a new sidewalk program to focus on parts of Seattle without sidewalks. The Seattle Department of Transportation has developed new approaches to sidewalk construction that dramatically reduce costs in areas that do not require significant investments in drainage infrastructure. This investment will be targeted to high pedestrian traffic areas and is expected to produce six to eight blocks of new sidewalks.

The 2006 Budget continued the City's support for the replacement of the Alaskan Way Viaduct and Seawall. In addition to a debt-financed capital budget of \$5.2 million, funding was provided for Center City traffic coordination and to begin to plan capital investments to improve traffic circulation when the Viaduct replacement project is under way. The Budget also provided continued funding for the South Lake Union streetcar project. The Budget does not include appropriations from the proposed Local Improvement District (LID). These appropriations will be made in 2006 after the LID is formed.

Despite the strong commitment to transportation made in the 2006 Budget, the City of Seattle and other Washington cities face a growing crisis in transportation funding. In May 2004 the Citizens' Transportation Advisory Committee presented a report to the Mayor and City Council describing the backlog of transportation projects and calling for new funding sources for local transportation. Seattle has lost more than \$18 million in transportation revenue annually due to the passage of Initiative 776 and court invalidation of the street utility. Mayor Nickels announced that he will propose a package of new transportation revenue measures in the spring of 2006.

Fire Department Staffing and Facilities: The 2006 Budget added \$1.3 million to the Fire Department to restore three on-duty strength positions, which necessitates five people per position in order to provide 24-hour per day coverage. The three positions will be assigned to the three engine companies that are the only unit at a particular station and that have only three-person crews. These are stations 16 (Green Lake), 21 (Greenwood), and 34 (Madison Valley). A new labor contract completed in late 2005 provides for additional working days for firefighters in order to add more on-duty positions in 2006.

The 2006-2011 Capital Improvement Program showed further progress in implementing the 2003 Fire Facilities and Emergency Response levy. Construction will begin on several new or remodeled fire stations during 2006, including the new Fire Station 10 complex that also houses the Emergency Operations Center and Fire Alarm Center. Supplemental legislation in mid-2005 added \$6 million of REET for this project, of which \$1 million will cover increases in construction material costs, \$1 million will be used to improve the environmental sustainability of the facility, and \$4 million will strengthen the neighboring Yesler Way overpass and build foundation components for a future Fire Department headquarters at the site.

Construction of two new fire boats began in 2005. The Joint Training Facility to serve the Fire Department and other departments is already under construction, with completion scheduled for mid-2006. The neighborhood fire stations replacement and remodeling program is experiencing significant cost increases due to materials prices and general construction inflation. This is expected to add costs in 2007 through 2013.

Human Services: The City joined other governments and many non-profit organizations in developing a Ten-Year Plan to End Homelessness in 2005. This Plan calls for a new approach to delivering human services that focuses on getting people into permanent housing with support services, rather than cycling through homeless shelters. Funding levels for direct human services were increased significantly in the 2006 Budget. The largest additions included \$1.0 million for the operating costs of Connections, the new homeless hygiene center located on Third Avenue; \$350,000 to maintain homeless shelter bed capacity while beginning the shift to fund transitional housing called for in the Ten-Year Plan; \$294,000 for a variety of programs to improve services for residents of South Park; \$275,000 to increase funding for community health clinics; and \$225,000 of additional funding for food programs. The Fleets and Facilities Department also received \$30,000 for operation of an emergency, severe-weather shelter in City Hall. King County voters approved a property tax levy lid lift for veterans and human services programs in November 2005, and the City expects to receive some of these funds in 2006 and beyond.

Seattle Center: Two major studies are underway regarding Seattle Center. The first is being conducted by a citizens' task force and will study all the Center's major programs and facilities. This group is expected to make proposals for new operating plans and possible capital improvements in the spring of 2006. The second study, by a

separate group, focuses on the future of Key Arena. The lease for the Seattle Sonics NBA franchise expires in 2010 and the Sonics want capital improvements to be made in exchange for a lease extension. The study currently underway will evaluate possible capital improvements to Key Arena with and without the Sonics as the lead tenant. There is some interest in State legislation to extend certain taxes as a way to pay for such improvements.

Environmental Protection: The Mayor and City Council have placed environmental protection as a high priority for City activity. Mayor Nickels announced three environmental programs in 2005: the Climate Protection Initiative, which focuses on reducing greenhouse gases as called for in the Kyoto protocol; Restore Our Waters, which calls for restoration of creeks and shorelines; and the Green Seattle Program, which focuses on increasing the tree canopy in Seattle. The Mayor signed an Executive Order requiring two-for-one replacement of any trees removed by City maintenance or development projects. Additional funds were provided in the 2006 Budget to pay for this order as it affects projects at Occidental and Freeway parks. The City Council added an additional \$184,000 for tree installation and maintenance.

Seattle's water system includes six open reservoirs storing treated drinking water. To comply with water quality regulations and enhance security, the City plans to cover or decommission all of its drinking water reservoirs over the next decade. Four open reservoirs have already been covered. Of the remaining six open reservoirs, SPU begins construction at the Beacon Reservoir in 2006 and is starting design work for the replacement of the Myrtle, West Seattle, and Maple Leaf reservoirs. The Department of Parks and Recreation has developed a park over the Lincoln Reservoir which was covered in 2005 and will be developing parks over the Beacon and Myrtle reservoirs.

The City's utilities have several facilities projects in their Capital Improvement Programs to meet federal and state regulatory requirements. The City must abide by U.S. Endangered Species Act regulations, which are designed to assist in species recovery efforts. In response to the listing of mid-Puget Sound Chinook salmon under the Act, Seattle Public Utilities (SPU) is implementing measures to facilitate fish passage near the Landsburg Diversion Dam on the Cedar River. Other projects include creating Cedar River downstream fish habitat and fish passage facilities, and protective fish screening to prevent salmon entrapment in the water supply system. City Light and SPU are also acquiring salmon habitat in the Green/Duwamish, Cedar/Lake Washington, Skagit, and Snohomish watersheds as part of the City's Early Action Plan.

Asset Preservation: During 2002 the City undertook an assessment of the demands for major maintenance and facility improvement projects. This effort, which was an outgrowth of the City's update to its 2001 financial policies, was intended to develop an annual funding target for major maintenance (now called "asset preservation") investments that would reflect an updated assessment of the City's capital infrastructure. The Asset Preservation Study found that, despite achieving targets recommended by the Citizens' Capital Investment Committee in 1994, the City still lags behind industry-recommended levels of investment in asset preservation.

Among the recommendations from the study are: setting the City's asset preservation funding target based on a percentage of the replacement value of all of the assets for which the City has asset preservation responsibility; funding asset preservation investments in part through user fees or internal rates; and actively engaging in property management strategies such as disposal, demolition, or retirement of facilities to reduce asset preservation obligations, and developing a comprehensive property management system which includes condition assessments, commissioning of new buildings, and life cycle analysis.

In 2006 the City is spending approximately \$91 million on asset preservation of general government infrastructure, including rehabilitation or restoration projects in parks, libraries, civic buildings, and on the Seattle Center campus. In SDOT, \$68 million funds asset preservation of roads and bridges in 2006. In the 2006-2011 Adopted CIP the City continues implementing the first recommendation of the Asset Preservation study by funding another set of projects in the Fleets and Facilities Department through Fleets and Facilities fund balance and space rent. For 2006, \$2.9 million is appropriated. Planned work ranges from the replacement of floor slabs and drainage at the Charles Street Maintenance Facility to the renovation of elevators at Seattle Municipal Tower.

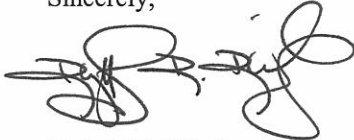
Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Seattle for its comprehensive annual financial

report for the fiscal year ended December 31, 2004. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

I would like to express my appreciation to the entire staff of Accounting Services, other members of the Department of Executive Administration, and other City departments who contributed to the preparation of this report. Finally, I thank you for your interest and continuing support in planning and conducting the City's financial operations in a responsible manner.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Dively", with a stylized, looping flourish extending to the right.

Dwight D. Dively, Director
Department of Finance

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Seattle,
Washington

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Carla E. Perry

President

Jeffrey R. Enen

Executive Director

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Seattle for its comprehensive annual financial report (CAFR) for the fiscal year ended December 31, 2004. This was the twenty-fifth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

City of Seattle
DEPARTMENT OF EXECUTIVE ADMINISTRATION

